HOUSE BUDGET COMMITTEE
DEMOCRATIC CAUCUS

Congressman John M. Spratt, Jr., Ranking Democratic Member
222 O'Neill House Office Building, Washington, DC 20515 • 202-226-7200
www.house.gov/budget_democrats/

June 29, 1999

Summary and Analysis of the President's Mid-Session Budget Review

Prepared by the Democratic Staff
of the House Budget Committee

This document has not been reviewed and approved by the Democratic Caucus of the Budget Committee and therefore may not necessarily reflect the views of all the members of the caucus.

General Notes:

- All years are fiscal years unless otherwise noted.
- Unless otherwise noted, funding levels for discretionary programs and entitlements and other direct spending programs represent outlays.
- All figures are OMB estimates.
- Numbers may not add due to rounding.
- Funding levels for 1999 are estimates and include emergency funding unless otherwise noted.

Table of Contents

Overview: Banking the Good News

The Mid-Session Review of President Clinton's Budget for 2000 constitutes the latest volume in an encyclopedia of good news: the economy is growing faster, unemployment and inflation are lower, and budget surpluses continue to grow faster than anticipated.

The President's updated budget framework:

- pays down the entire publicly held federal debt by 2015;
- results in an on-budget surplus — a surplus without counting Social Security — in ***every*** year starting in 2000;
- extends the solvency of the Social Security and Medicare trust funds by decades; and
- ***contingent*** on congressional agreement to reserve a specified amount of the on-budget surpluses for Social Security and Medicare, thereby extending their solvency, devotes the remainder of the on-budget surplus to —
  modest increases in discretionary programs,
  targeted tax cuts in the form of Universal Savings Accounts, and
  a new Medicare prescription drug benefit.

Social Security and Medicare Solvency

The President specifically reiterates his pledge to save Social Security and Medicare first. He plans to extend the solvency of the Social Security and Medicare trust funds by transferring on-budget amounts from the general fund to those trust funds. The President says that congressional agreement to such a plan, and to a "lockbox" to prevent us from later unraveling the protection given to Social Security, is a precondition for any programmatic increases or tax cuts.

- **Social Security** transfers will start in 2011 and will be linked to the amount of on-budget interest savings accruing from the reduction, starting in 2000, in publicly held debt. The transfers will continue past 2014, and will be invested in the stock market, up to a limit. The transfers will total $543 billion from 2010 through 2014, and the resulting earnings are estimated to produce another $87 billion over that period. The transfers and the earnings on them will extend the solvency of the Social Security trust funds for an additional two decades, to 2053.

- **Medicare** transfers will begin in 2000 and, through 2009, will equal the entire $323 billion on-budget surplus that remains after the program increases and tax cuts called for by the President. The Medicare transfers will be invested in Treasury securities. Starting in 2011, the Medicare transfers will equal all of the remaining on-budget surplus except the portion transferred to Social Security. The Medicare transfers are expected to extend the solvency of the Hospital Insurance (Part A) Trust Fund for about a decade, to 2025.

How the President Uses Surpluses

Use of Projected Ten-Year *Unified Budget* Surpluses

Over ten years (2000-2009), the President proposes to use projected unified (i.e., total) budget surpluses as follows (dollars in billions):

Baseline surplus (capped baseline)	**$2,926**	**100%**
Discretionary programs	328	
Tax cuts, i.e. Universal Savings Accounts	250	
Prescription Drug Benefit (net)	50	
Debt service costs	132	
subtotal, portion of surplus consumed	**760**	**26%**
Resulting surplus, used to reduce debt:		
On-budget surplus: all transferred to Medicare	323[1]	
Off-budget surplus: 100% retained by Social Security	1,843	
subtotal, portion of surplus used to reduce debt	**2,166**	**74%**

Use of Projected Ten-Year *On-Budget* Surpluses

Another way to portray the President's budget is to say that he plans to devote 100 percent of the Social Security surplus to the exclusive use of that trust fund in every year, and to divide up the projected $1.1 trillion "on-budget," or non-Social-Security, surplus as follows (dollars in billions):

Baseline Surplus (capped baseline)	**$1,083**	**100%**
Discretionary programs	328	
Tax cuts, i.e. Universal Savings Accounts	250	
Prescription Drug Benefit (net)	50	
Debt service costs	132	
subtotal, portion of surplus consumed	**760**	**70%**
Resulting surplus: to reduce debt & for Medicare solvency	**323**	**30%**

[1] OMB and CBO treat the administrative expenses of the Social Security program, about $3.5 billion per year, as an off-budget expense. However, congressional budget resolutions (including the Republican budget resolution of April), do not, because those administrative expenses are covered by the discretionary caps. As a result, for congressional purposes the on-budget surplus is $35-$40 billion lower than shown in the tables above, while the off-budget surplus is that much greater.

Use of Projected Fifteen-Year *Unified Budget* Surpluses

Much of the discussion in the Mid-Session Review concerns fifteen-year totals rather than the ten-year figures used by Congress in its FY 2000 budget resolution. The following table shows totals for fifteen years (dollars in billions):

Baseline Surplus (capped baseline)	**$5,935**	**100%**
Discretionary programs	522	
Tax cuts, i.e. Universal Savings Accounts	540	
Prescription Drug Benefit (net)	71	
Debt service costs	469	
subtotal, portion of surplus consumed	**1,602**	**27%**
Resulting surplus, used to reduce debt:		
On-budget surplus: transferred to Medicare	723	
transferred to Social Security	543	
Off-budget surplus: 100% retained by Social Security	3,067	
subtotal, portion of surplus used to reduce debt	**4,333**	**73%**

The June Mid-Session Review versus the February Budget

The President's budget has changed since February. First, over ten years, estimated unified budget baseline surpluses have increased by $517 billion, from $2.4 trillion to $2.9 trillion. ($333 billion of the improvement is in accounts other than Social Security.) Of this $517 billion improvement, the President devotes more than 90 percent to additional debt reduction. Thus, both the total amount of debt reduction and the percentage of the surplus devoted to debt reduction are now greater than in February.

Second, the contingent initiatives have changed somewhat, as shown below. The new proposal for a prescription drug benefit, though small in net, is the focus of the changes.

Policy Changes to the Baseline Surplus, February and June
Ten-year totals in billions

	February	**June**
Baseline Surplus (capped baseline)	**$2,409**	**$2,926**
Discretionary programs	318	328
Tax cuts, i.e. Universal Savings Accounts	273	250
Prescription Drug Benefit (net)	0	50
Debt service costs	139	132
subtotal, portion of surplus consumed	**729**	**760**
Resulting surplus, used to reduce debt	**1,681**	**2,166**

Third, the President scales back his contingent initiatives in the early years. Combined with the improvement in the underlying estimates, this allows his June budget to produce on-budget surpluses in *all* years starting with 2000. In contrast, his February budget did not achieve an on-budget surplus until 2006.

Finally, the President now limits his general fund transfers to the amount of the remaining on-budget surplus, whereas his February budget proposed general fund transfers to Social Security and Medicare independent of the balance of the on-budget accounts.

Discretionary Spending

The plan for discretionary spending in the President's budget remains essentially unchanged since February. That plan adheres to the existing discretionary caps in 2000, using OMB estimates and counting proposed entitlement cuts, proposed user fees, and proposed revenues as offsets to be enacted by the Appropriations Committee. (Congressional rules do not allow the use of revenue increases as an offset for discretionary programs.)

For years after 2000 and contingent on agreement to a Social Security and Medicare solvency plan like that advanced by the President, the budget allows an increase in discretionary programs. However, that increase is relative to the "capped" baseline — a baseline that follows the caps downward in 2001 and 2002 and then freezes them in real (inflation adjusted) terms thereafter. Thus, the capped baseline allows even less real resources than the existing 2000 caps, which are widely viewed as being too tight. The President's proposed increase would restore some of the purchasing power lost by discretionary programs, but it does not restore them even to the real 1999 level *before* last fall's emergency appropriations for 1999.

OMB versus CBO Estimates

In February, CBO estimated that the ten-year budget surplus would be about $200 billion greater than OMB thought; CBO projected a $2.6 trillion surplus while OMB projected a $2.4 trillion surplus. Given the wide range of uncertainty involved in the projections, this constituted near unanimity.

As noted, OMB's June baseline is $517 billion more optimistic than its February baseline over ten years. As a result, OMB is now about $0.3 trillion *more* optimistic than CBO over the ten-year period. But CBO intends to produce an updated forecast by Thursday, July 1st, and that forecast is certain to be more optimistic than before. As a result, CBO's new figures could be close to OMB's new figures.

Social Security

The Mid-Session Review modifies the Social Security framework put forth in February in President Clinton's Budget for 2000. It still proposes that all spending and tax initiatives be fully offset until Congress enacts an overall agreement to extend the solvency of the Social Security and Medicare trust funds. It still proposes that the lion's share of future surpluses be used to pay down debt. It still proposes that the Social Security trust fund receive transfers of new resources from the Treasury that reflect the improvement in the Treasury's financial condition as the debt is reduced. Finally, it still invests a portion of the transfers to the trust fund in private-sector securities. However, the framework in the Mid-Session Review differs from the February budget in its details.

The Mid-Session Review still maintains the fiscal discipline of the discretionary spending caps and the pay-as-you-go rule until an overall agreement is enacted to extend the solvency of the Social Security and Medicare trust funds. It is not clear, though, whether these fiscal restraints can be relaxed by achieving something short of 75-year solvency, as called for in the February budget. The Mid-Session Review estimates that the President's new proposals extend Social Security's solvency until 2053, and cites the Administration's willingness to work in a bipartisan fashion to achieve 75-year solvency.

The Mid-Session Review again reserves for debt reduction an amount equal to the Social Security surplus over the next fifteen years. However, unlike the February budget, all of the Social Security surplus ***in each and every year*** is dedicated to paying down the public debt. Exceptional economic performance has boosted the outlook for the projected Social Security surplus just as it has for the non-Social Security surplus. This means that $3.1 trillion is devoted to debt reduction over the next fifteen years, as opposed to $2.8 trillion in the February budget. This, along with associated reduction in interest costs, entirely eliminates the publicly held debt by 2015.

The Mid-Session Review unveils a new "lockbox" to ensure that the entire Social Security surplus is taken off-budget and used for the intended purpose of debt repayment. The Administration suggests that new budgetary rules be put in place to require that all Social Security revenues be used only to pay benefits promised under current law or to repurchase publicly held debt. However, the enforcement procedures to implement this proposal are not specified.

As was the case in the February budget, the Mid-Session Review transfers new resources from the Treasury to the Social Security trust fund. However, these transfers do not begin until 2011, rather than immediately as called for in the February budget. In 2011, the transfers would equal the reduction in the Treasury's interest cost that resulted from dedicating the Social Security surplus to debt repayment.

OMB estimates that for 2011 through 2014, reserving the Social Security surplus for debt reduction will lower the Treasury's interest expense by $543 billion. That amount will be transferred to Social Security during those years, reflecting the improvement in the Treasury's financial condition. By 2015, the public debt will be eliminated completely by preserving the Social Security surplus. Treasury's interest expense will be $189 billion lower per year, and transfers to the Social Security trust fund in this amount will therefore continue every year thereafter.

At first, the transfers to the Social Security trust fund will be used entirely to purchase private-sector securities. This continues until these securities comprise an unspecified but limited proportion of total trust fund assets. Thereafter, the transfers will be invested in Government securities.

Medicare

President's February Budget for 2000

President Clinton's Budget for 2000 released in February extended the life of the Medicare Part A Trust Fund to 2020 by dedicating 15 percent ($686 billion) of the unified budget surplus over 15 years to the Part A Trust Fund. Without the funds provided in the February budget, the Medicare Part A Trust Fund was expected to be exhausted in 2008.

In March, the Medicare Trustees reported that the Part A Trust Fund would remain solvent until the year 2015. The Trustees Report updates the Medicare projections annually, and bases the projections on the most probable economic and demographic assumptions.

Mid-Session Review

The Mid-Session Review maintains the framework of the February budget for Medicare, but the figures are updated to reflect increases in the surplus and revisions in Medicare. The Mid-Session Review extends the life of the Part A Trust Fund to at least 2025 by dedicating 15 percent ($794 billion) — $108 billion more than the amount provided in February — of the unified budget surplus to the Part A Trust Fund over 15 years.

Medicare Reform Package

In addition to extending the solvency of Medicare's Part A Trust Fund, the President is expected to announce the details of his plan to reform Medicare on Tuesday, June 29, 1999. The reform package is expected to include the following revisions: 1) modernize structure of the program; 2) relieve certain providers from some reductions imposed by the Balanced Budget Act of 1997 (BBA); 3) extend some provider reductions beyond the BBA's effective dates; 4) establish a universal, outpatient, prescription drug benefit; and 5) improve efficiency from suppliers for goods and services.

Note: Once the details are made public, we will release an updated Medicare document.

Revenues

The revenue proposals in the Mid-Session Review are virtually unchanged from those in President Clinton's budget for 2000 released in February. The Administration is calling for the same package of targeted tax cuts, including tax cuts for long-term care, child care, and school construction, totaling $32.9 billion over five years and $76 billion over ten years. These tax cuts are to be fully offset by the previously proposed revenue increases such as limiting corporate tax shelters, taxing investment income of trade associations, and replacing sales-source rules, totaling $34.7 billion over five years. In addition, the Mid-Session Review proposes raising $45.1 billion in new excise taxes and user fees to offset discretionary spending. These offsets are the same as those put forward in February, including a large hike in tobacco taxes. None of these revenue initiatives is contingent on enacting an overall agreement to extend the solvency of the Social Security and Medicare trust funds.

The Mid-Session Review again calls for the implementation of the President's Universal Savings Account (USA) proposal, which the Administration structures as a refundable tax cut. Unlike the revenue changes above, USAs are contingent upon enactment of Social Security and Medicare reform. USAs are now estimated to cost $26.3 billion over five years and $250.4 billion over ten years, which is considerably less than the February budget that estimated $96 billion over five years and $272 billion over ten years. Over fifteen years, however, OMB estimates that USAs cost $540 billion, slightly more than in the February budget. The Administration says that this extended phase-in of USAs is required to develop the necessary systems to administer the accounts.

Discretionary Programs

Overview

President Clinton's Budget for 2000, released in February, proposed to use part of the surplus, beginning in 2001, to increase funding for discretionary programs ***provided*** Congress first enacts an overall agreement to extend the solvency of the Social Security and Medicare trust funds. In the Mid-Session Review, the President bolsters his pledge to save Social Security and Medicare first by proposing to use only on-budget surpluses, rather than unified budget surpluses, to increase funding for discretionary programs. As in the February budget, the Mid-Session Review does not use any of the surplus to increase funding for discretionary programs in 2000. The Mid-Session Review, however, contains $10 billion more in funding for discretionary programs over 10 years and $41 billion more over 15 years than the February budget.

Background

"Discretionary" programs are those controlled by the annual appropriations process. In the Bipartisan Summit Agreement of 1990, statutory dollar limits or "caps" were placed on discretionary budget authority and outlays for 1991 through 1995. A "sequestration" mechanism was created to make across-the-board cuts automatically if, at the end of each session of Congress, OMB determined that Congress had breached the caps. The discretionary caps were extended through 1998 when President Clinton's first budget was enacted in 1993, and the 1997 Bipartisan Budget Agreement revised and extended these caps through 2002.

Using the On-Budget Surplus for Discretionary Programs

The February budget proposed to use a portion of the unified surplus to raise the discretionary caps in 2001 and 2002 and overall levels of discretionary funding thereafter (contingent upon enactment of an overall agreement to extend the solvency of the Social Security and Medicare trust funds). This increase totaled $481 billion through 2014. As the comparison below indicates, the Mid-Session Review proposes using $522 billion in on-budget surpluses over fifteen years to supplement funding for discretionary programs, an increase of $41 billion over the February budget:

Year	February Budget	Mid-Session Review
2001-2004	$138 billion	$138 billion
2005-2009	$180 billion	$190 billion
2010-2014	$163 billion	$194 billion
	$481 billion Total	$522 billion Total

In the first five years, the Mid-Session Review provides the same amount as the February budget. However, the Mid-Session Review shifts funding between 2001 and 2002. The Mid-

Session Review provides $5 billion ***less*** of the surplus to fund discretionary programs in 2001 and provides $5 billion ***more*** in 2002.

Defense and Non-Defense Funding

The Mid-Session Review does change how surplus funds are allocated between defense and non-defense discretionary programs. The February budget proposed $164 billion of the surplus for defense readiness, $226 billion for non-defense priorities, and $91 billion as a reserve for either defense or non-defense priorities.

The Mid-Session Review discards the reserve concept and instead provides $183 billion for defense, $156 billion for a Children and Education Trust Fund, and $183 billion for remaining non-defense priority programs (e.g., programs for veterans, protecting the environment, and aiding U.S. farmers). The additional $41 billion thus is split almost evenly between defense ($19 billion) and non-defense ($22 billion) programs.

Children and Education Trust Fund

The $156 billion dedicated to Children and Education Trust Fund will be in addition to the amounts assumed by the Balanced Budget Act of 1997. The President plans to work with Congress to develop the appropriate allocations among major education and health programs for America's children. The programs likely to benefit from this trust fund are: Head Start; Title I - Education for the Disadvantaged; after-school programs; Class Size Reduction; the Safe Schools/Healthy Students Initiative; special education; Pell Grants; Maternal and Child Health Block Grant; childhood immunizations; research on children's health; and the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC).

The Discretionary Bottom Line

While the $522 billion infusion into discretionary programs between 2001 and 2014 appears to be a large increase, it will have a modest effect on discretionary spending over the long-term. As a percentage of gross domestic product (GDP), discretionary spending steadily declines even with this infusion of funds, going from 6.6 percent of GDP in 1999 to 5.8 percent in 2004.[2]

---

[2] Measuring government programs or spending categories as a percentage of GDP is widely used but is imperfect. For example, if the economy is growing but defense requirements, which are linked to military threats and not the economy, do not change, then the defense share of GDP will naturally decline without any adverse effect. However, many non-defense programs (such as low-income programs) are affected by economic conditions.